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CRA warns on RCA abuses

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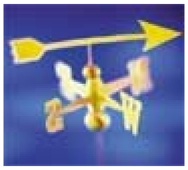

An internal letter suggests Canada's tax authorities intend to crackdown on what they consider abusive use of retirement compensation arrangements (RCAs).

In a recent newsletter, Retirement Compensation Funding Inc. (RCF) pointed to CRA's response to a question from an assessment office on the deductibility of employees' contributions to an RCA. CRA used the case as a "platform to address what they consider to be abusive in the use of RCAs in tax planning and to instruct CRA employees what facts to consider when reviewing an RCA," RCF said.

"It has recently come to our attention that innovative tax plans purported to be RCAs are being marketed and promoted to allow both employers and employees to avoid tax and offer further benefits to employees over and above those offered to registered plans," the CRA letter reads.

"For this reason, excessive contribution amounts and/or suspicious activities involving the use of an RCA…should be flagged for further review."

RCAs are designed to provide supplemental pension benefits for senior executives and owner-managers, and are also used to provide pension benefits to an employee or an employee group in situations where a company does not have a registered pension plan in place. They were first used to fund the difference between the total pension promise by a corporation to an arms length executive over what could be provided by the firm's DB plan.

RCF says it has examined some employer/employee contribution arrangements currently being marketed which would be considered "clearly abusive" by CRA.

The CRA's letter supports a conservative position on RCAs, RCF adds. For example, if a company had a money purchase pension plan that required employee and employer contributions, and an RCA were established to cover employees hurt by the cap on money purchase plan contributions, it would be acceptable for the RCA to require employee and employer contributions in the same proportion, provided the employee's contribution does not exceed 50%.

In the newsletter, RCF strongly recommends that clients only use RCAs for legitimate pension purposes. "More importantly, CRA guidelines should be followed and in questionable areas, seeking an advance tax ruling is the most prudent decision one could make."

To read a pdf copy of the RCF newsletter, please click here.

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